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SUBJECT: RUSSIA: BARRIERS TO BUSINESS: CREDIT, TAXES, AND
BUREACRACY

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¶1. (SBU) Summary. A recently-released survey of 3,000 business shows a surprising convergence of opinion between small, medium, and large enterprises about what stands in the way of commercial success in Russia. Respondents uniformly identified the high cost of credit, high tax rates, and ineffective government as their top concerns. These results seem generally consistent with what entrepreneurs have told us during interviews for the Economic Weekly "SME Success" series: credit is expensive and access is somewhat limited; taxes are too high and the tax code is incomprehensible; the bureaucracy is too slow and property rights are murky; energy prices are escalating. While corruption remains a concern, the survey confirms our anecdotal evidence that it has become more routine and predictable, and thus almost a part of the business planning process, and therefore registered surprisingly low among barriers to business identified by survey participants. End Summary.

INDEM SURVEY: BARRIERS TO BUSINESS IN RUSSIA

¶2. (SBU) INDEM, a well-known non-governmental organization in Russia, regularly conducts research on topics such as corruption and economic development. In its most recent report, "Business and Corruption: Prevention 2006," INDEM staff surveyed approximately 3,000 small, medium, and large businesses in the Moscow Region, Smolensk, and Volgograd. Participants were asked to rank order the seriousness of 33 obstacles to doing business in Russia. A full copy of the report is available (in Russian) at INDEM's website at www.indem.ru.

CREDIT EXPENSIVE BUT EASY TO GET

¶3. (SBU) Survey participants indicated that while banks were more willing to consider loans based purely on business plans (with no collateral) the cost of borrowing is still prohibitively high in Russia. SME entrepreneurs we have talked to agree that commercial credit is much easier to obtain now, but still expensive. Banks consider business loans (especially those with less fluid collateral) inherently more risky and, therefore, charge higher interest rates -- on average 10.7%, depending on the region.

TAXES TOO HIGH AND TAX CODE TOO COMPLEX

¶4. (SBU) After the high cost of credit, businesses uniformly cited a high tax burden as a significant impediment to

growth. No less irritating to business is the tax code itself, which made into the top five barriers. SMEs are notorious for hiding their income -- most tell us that they keep up to 80% of their earnings under the table. They complain to us that they cannot compete with firms that cheat on their taxes if they do not cheat themselves. The bookkeeping alone necessary to register employees and comply with tax regulations is too cumbersome and the chance of getting caught is negligible. A downside for firms that conceal so much of their earnings is that they (and their employees with falsified pay stubs) can borrow only a fraction of what they ought to be able to with their real income, given that banks will only accept official income for credit applications. More and more firms see access to more substantial credit worth the heartache of leaving the comfort of the shadow economy.

BUREAUCRACY INEFFICIENT

15. (SBU) Bureaucratic hurdles continue to annoy (a top three concern). Entrepreneurs tell us the paperwork required to run a business is cumbersome and hurts their bottom line. In this rapidly growing economy, businesspeople do not have time to waste waiting for bureaucratic permissions while their competitors race ahead. Entrepreneurs pay well known amounts to an array of people to facilitate their paperwork. They see it as a expediting fee-for-service and a widely accepted practice. In fact, were the bureaucracy to formalize these expediting fees and pay staff overtime for clearing those papers more quickly, the market result would likely be nearly the same.

PROPERTY RIGHTS WEAK

16. (SBU) Lack of legal protection for property also ranked high among business concerns. Protecting your real estate is an ongoing headache for business. As hard as finding new space to lease or buy may be, entrepreneurs we have talked to are equally concerned about holding on to their space. As real estate prices sky rocket in many Russian cities, landlords often forcibly evict tenants from buildings even if the lease is still in force. In a November 15 meeting, INDEM President Georgiy Satarov cited the Federal Law on the Privatization of State and Municipal Property (which states that all municipal property ought to be auctioned off by 2009) as a particular hurdle for SMEs. The concern is that SMEs currently leasing such property may lose it when a new owner takes control. Satarov believes the law should be amended to give SMEs preferential rights to purchase the property they are leasing before it gets opened up to others.

ENERGY PRICES TOO HIGH

17. (SBU) Rising energy prices have hurt Russian businesses, as elsewhere. According to the study, the high cost of energy was of particular concern to large companies (number 4), but also ranked in SMEs' top ten. Businesspeople say that recent increases in energy costs have seriously hurt their bottom line. Not stated in the study is another serious problem facing entrepreneurs -- the difficulty of hooking up new developments to existing utility services. We have met businesspeople who are eager to build greenfield facilities but who are forced to stay in their current dilapidated structures simply because of a lack available electricity.

CORRUPTION A PROBLEM, BUT MORE ROUTINE NOW

18. (SBU) INDEM's survey asked a variety of questions about corruption, focusing on court decisions, lack of predictability, and the efficacy of the undertaking. All of these scored lower on the list than one might have expected. We enjoyed the fact that the survey clearly assumed that corruption was present, and merely sought to clarify its pervasiveness and whether it is an impediment to business. The answers seemed clear: corruption exists, but it is a

manageable cost of doing business. Our "SME Success" interviewees say that everyone knows exactly what to pay to whom for what. And, like other "fee-for-services," they usually get what they pay for. For most small and medium entrepreneurs, at least, bribe-paying in Russia appears to have hit its supply-demand equilibrium.

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